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HOW TO TAX E-COMMERCE – GLOBAL OR NATIONAL PROBLEM?

Introduction

During the past two decades, financial markets around the world have become increasingly interconnected. Financial globalization has brought considerable benefits to national economies and to investors and savers, but it has also changed the structure of markets, creating new risks and challenges for market participants and policymakers. Three decades ago, a manufacturer building a new factory would probably have been restricted to borrowing from domestic bank. Today it has many more options to choose from. A look at how financial globalization has occurred, and the form it is taking thanks to advanced technology, offers insights into its benefits as well as the new risks and challenges it has generated.

E-commerce challenges the current international tax regime. Currently, the regime recognizes territorial taxation by the source country and personal taxation by the resident country. But, cross border e-commerce as a global commerce challenges these territorial and personal concepts and ties to a bordered country which makes it difficult to normatively justify and practically implement the current international tax regime on cross border ecommerce income.

1. Global Taxation of Cross-border E-commerce Income – current international regime

The international tax regime, which developed in the 1920s[1], recognizes two bases for tax jurisdiction[2]. The first is source-based taxation, or territorial jurisdiction. In source-based taxation, the country has jurisdiction to tax income sourced

[1] M. Graetz, M. O'Hear: *The Original Intent of U.S. International Taxation*, 1997. Faculty Scholarship Series. Paper 1620, pp. 1066-89, http://www.digitalcommons.law.yale.edu/fss_papers/1620.

[2] Double Taxation and Tax Evasion: Report Presented by the Comm. of Technical Experts on Double Taxation and Tax Evasion, League of Nations Doc. G.216M.85 1927 II (1925).

to its territory. Source rules determine the source of the income for this purpose by distinguishing between different categories of income. Hence, income classification is the first necessary step in the imposition of source-based taxation. The justification for source taxation is that the source country has contributed infrastructure and other facilities to the process of income production[3].

The second basis for tax jurisdiction is resident or personal jurisdiction. In resident-based taxation, the country has jurisdiction to tax its residents on their worldwide income. In this system, the determination of residency for tax purposes is critical and is usually based on the personal, social, and economic ties of the person to his country. The justification for resident taxation stems from the contribution of the country of residence to the abilities of the income producer. It is alternatively justified by the notion of a social contract between the members of the country and the governing body.[4] Unfortunately these two bases of taxation occasionally lead to double taxation. It should be underlined, that area of taxing natural persons as well as legal has a wide range. This scope includes among others: profits of enterprises, profits from air transport, dividends, interest, licence amounts due, retirement pensions or incomes of students.

The problem of international tax regime in the article limits only to global taxation of cross-border e-commerce defined as income deriving from a cross-border transaction taking place wholly or partially on the Internet, so e-commerce involves more than one country in the transaction.

The term "e-commerce" has several definitions. The United Nations Commission on International Trade Law (UNCITRAL) has defined electronic commerce as "commercial activities conducted through an exchange of information generated, stored, or communicated by electronic, optical, or analogous means"[5]. The U.S. Department of the Treasury defines e-commerce as "the ability to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques"[6]. More specifically, electronic commerce has become an umbrella term for telecommunications activities conducted over open computer networks, such as the Internet[7]. The OECD

3 Reuven S. Aviyonah et al.: *U.S. International Taxation: Cases And Materials* (3rd Ed. 2010).

4 M.S. Kirsch: *Taxing Citizens in a Global Economy*. 82 N.Y.U. L. REV. 443, 445 (2007); E.A. Zelinsky: *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile 96*. "IOWA L. REV." 2011, 1289, 1323.

5 R. Hill, I. Walden: *The Draft UNCITRAL Model Law for Electronic Commerce: Issues and Solutions*. 13 COMPUTER L. 18 (1996).

6 *Selected Tax Policy Implications of Global Electronic Commerce*. Department of the Treasury (1996), available at http://www.treasury.gov/resource-center/taxpolicy/Documents/internet.pdf.

7 See OECD, OECD Policy Brief No. 1-1997 (from http://www.oecd.org/publications/ Pol_brief/9701_pol.htm).

has defined the term, "electronic commerce" as referring generally to commercial transactions, involving both organizations and individuals, that are based upon the processing and transmission of digitized data, including text, sound and visual images and that are carried out over open networks (like the Internet) or closed networks (like AOL or Minitel) that have a gateway onto an open network[8].

E-commerce enterprises can sell their products or services worldwide with very limited physical presence in any particular consumer's country and can operate without agents because they can directly, easily, and cheaply contact customers worldwide. However, it should be emphasized that is if e-commerce hadn't introduced enough regulatory complexity, now we have got m-commerce, what means: the exploding market for mobile phone applications and financial transaction. It is a huge rapidly expanding market. This market has only existed for about five years, but it's already credited with $20 billion annual revenues and what's more is the frontiers of m-commerce are limitless[9].

A global e-commerce tax would handle the challenges of global e-commerce taxation appropriately. Currently, individual countries cannot effectively tax cross border e-commerce income and the proposed model would enable the taxation of such income. The challenges derive from the global nature of e-commerce and the irrelevance of territory and orders, which constitute the mainstay of the current international tax regime.

We can distinguish between three types of e-commerce: ecommerce in tangible products (for example, buying a hard copy of a book in internet shops), e-commerce in intangible products (for example, downloading a song from Apple.com/itunes) and e-commerce in services (for example, booking a hotel on booking.com or turez.com). All three types of e-commerce are *global*, in the sense that e-commerce takes place on the globe without real meaning attaching to territorial borders between countries. E-commerce ignores or even destroys territorial borders[10].

All types of e-commerce are *virtual* to some extent, in the sense that their existence is on the Internet and their physical existence outside the Internet is limited. The correct answer to the question of where e-commerce occurs is "on the Internet." Any attempt to pinpoint the location of e-commerce in terms of a geographical location outside the Internet is artificial. The last feature of all types of e-commerce is its *anonymity*, in the sense that the e-commerce transaction, its par-

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8 Ibid.

9 J. Hayward: *M-Commerce Brings a New Marketplace to Your Pocket*. "Human Events" October 1, 2012, Vol. 68. Iss. 37, p. 17.

10 D. Johnson, D. Post: *Law and Borders – The Rise of Law in Cyberspace*. 48 STAN L. REV. 1996, 1367, 1370-76.

ties, and its details are at least partially anonymous or require intensive investigation to discover its parties and details. However, the three types of e-commerce differ in terms of the extent to which each of them is global, virtual, and anonymous. Generally speaking, e-commerce in tangibles is less global and less virtual than e-commerce in intangibles, and e-commerce in services lies somewhere in between. This difference has tax ramifications — as the global or virtual component of the e-commerce increases, the tax challenges become more profound.

The current international tax regime and of e-commerce marketplaces reveals the significant gap between them: they differ in their working presumptions, their perspectives, and their guiding conceptions. The lack of compatibility between the current international tax regime and the features of e-commerce presents tremendous problems in taxing global e-commerce income, as a result of which there is a serious undertaxation with respect to cross-border e-commerce income. The challenges are as follows.

First, the rationale and justification of source taxation is not clear. What is the special contribution of the source country that justifies its tax jurisdiction? Second, the determination of the source country is challenging because the income is tied to several locations without clear contribution of one location over the other: the hardcopy transaction is connected to the United States, Britain, Germany, and Israel; the e-book transaction is connected to the United States, Canada, and Israel; the subscription transaction is connected to the United States and Israel. The determination of the source country in each transaction is neither easy nor convincing. Third, and maybe most important, even if these questions were answered and the source of the income determined, it is not normatively clear that the conclusion sets the tax jurisdiction fairly and efficiently. For example, if Amazon pays its taxes on the transactions to the United States only[11], it is not certain that this is a fair and efficient sharing of the "tax pie" in the twenty-first century. To put it in general terms, e-commerce challenges the conceptual, practical, and normative basis of the current source rules.

2. Tax challenges

The problem concerns every taxpayer, who will be personally interested in the transaction by internet to avoid taxes but the huge problem is for public finance by losing tax revenues from big companies. Big gambling companies that

[11] AMAZON.COM, INC., 2010 ANNUAL REPORT, available at http://www.phx.corporate-ir.net.

make billions of dollars online while they incorporate in tax havens. Several other industries are clearly offshore-based, but make billions of dollars from transactions and services to Americans and other customers in developed countries without these countries collecting any tax revenue on these incomes. It is clear that the roots of the challenge here are planted on the existence and widespread availability of tax havens, but e-commerce makes these havens much more attractive.

The tax challenges identified do not pertain solely to companies or taxpayers who intentionally skirt the law. The challenges are also significant for companies who obey the law. To make this point and some additional points. A good example can be Google. Google declares on its website that "Google's mission is to organize the world's information and make it universally accessible and useful."[12] Google generates billions of dollars from advertising globally. As Google's Quarterly Earnings Summary for the fourth quarter of 2011 reveals, its revenues in the quarter reached the sum of $10,584,000,000, while 53% of revenues were from international sources and 47% of the revenues were from the United States[13]. Google's financial information also indicates that the share of Google's international revenues is growing[14]. In 2012, the U.S. Census Bureau estimates, retail e-commerce totalled $225 billion, an increase of almost 16 per cent from 2011. Online purchases now account for 5.2 per cent of total retail sales. The subsidy—worth about $23 billion today, according to Bloomberg News, and about $52 billion in unpaid state sales taxes since 2006—has helped nurture e-commerce through its start-up, although that success came at the expense of brick-and-mortar rivals[15]. Over the past decade retail e-commerce sales have increased approximately twenty four times faster than non-e-commerce retail sales[16].

But how are all these revenues taxed? It is not easy to answer this question. It is very difficult to classify Google's income. It is not easy to determine the source country of the income which is generated through clicks by worldwide users. The sharing of the tax pie on Google revenues is very much problematic: while more than half of the revenues are international, Google does not really pay taxes to non-U.S. governments. Google declares that "Our effective tax rate was 22% for the fourth quarter of 2011"[17]. This rate is quite low in comparison to oth-

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[12] About Google, GOOGLE, http://www.google.com/about.

[13] Q4 2011 Quarterly Earnings Summary, GOOGLE, http://www.investor.google.com/pdf. 2011Q4_google_earnings_slides.pdf.

[14] Ibid.

[15] *It's Time to Start Taxing E-Commerce*, "Businessweek" April 25 2013.

[16] U.S. Census Bureau: "2009 Quarterly E-Commerce Report", http://www.census.gov/retail/ mrts/www/data/html/09Q4table4.html.

[17] Press Release, Google Inc., Google Announces Fourth Quarter and Fiscal Year 2011 Results (Jan. 19, 2012), available at: http://www.investor.google.com/pdf/2011Q4_earnings_google.pdf.

er companies. More important, however, is the fact that Google's effective tax rate on its international income is 2.4%.[18] This is because Google uses aggressive tax-planning strategies to reduce its effective tax rate. The strategies of Google depend on "transfer pricing" practices combined with low income jurisdictions and treaty holidays[19]. These strategies are available to all kind of businesses but they are much more available and valuable to e-commerce businesses like Google.

3. Proposition to improve international tax regime

Technology has dramatically affected taxation and the way in which it is imposed. Rapidly increasing e-commerce transactions, which have guarded online retailers and consumers the tax-free click, are forcing the traditional world of tax, commerce and international trade to meet unprecedented challenges. The development of the internet has expedited globalisation, which in turn has compounded taxation. because electronic commerce transactions are more likely to cross international borders than non-e-commerce transactions, e-commerce activities may be subject to a morass of conflicting national and local laws and regulations.

The current regulatory environment inhibits the ability of the Internet to move e-commerce transactions around the globe in the most efficient and optimal manner. Especially now, when many states, facing budget shortfalls and fiscal pressure, have set their sights on e-commerce in their search for new opportunities to increase state revenues. State officials argue that this would not create new taxes, only better enforce existing tax requirements. In most states, consumers are required to pay use taxes on items purchased out-of-state, but states have limited ability to enforce this requirement. Requiring merchants to collect the tax is the only realistic way for states to obtain this tax revenue.

The European Commission's "Initiative In Electronic Commerce" was released in the spring of 1997 amidst concerns that the rapid implementation´ of e-commerce poses an enormous challenge for commerce, industry and governments in Europe. One of these challenges, the Initiative states, is that Europe's main competitors have already resolutely seized opportunities offered by electronic commerce with the US building a substantial lead[20].

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[18] J. Drucker: *Google 2.4% Rate Shows How $60 Billion Lost to Tax Loopholes*. BLOOMBERG, Oct. 21, 2010, http://www.bloomberg.com/news/2010-10-21/. google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html.

[19] B. Dooley: *Study of the Google International Tax Planning from Chapter Seven of International Taxation in America*. INT'L TAX COUNS. BLOG, http://www.intltax.counselors.com/blog/?page_id=5762.

[20] European Commission, A European Initiative in Electronic Commerce, available at: http://www.cordis.lu/ esprit/src/ecomcomx.htm> (last modified April 16, 1997). See also Aspen Law & Business, European Union Considers Regulatory Framework for Electronic Commerce, 16 No. 12 Banking Rep. 10, 10 (1997).

On 9 November, 2011 The European Commission adopted, a next proposal for a new programme – *Fiscus*, designed to improve the effectiveness of national customs and taxation system also in the field of e-commerce taxation. According to Commission, e-commerce represents an opportunity for business and consumers to avoid taxation but increasingly obliges customs administrations to develop new approaches to collect revenues and prevent tax evation[21].

General assumptions and proposals in the field of e-commerce taxation were also indicated by the WTO and OECD, which plans to play a central role in global e-commerce regulation.

According to D. Castro[22] policymakers should adhere to three key principles as they craft a system for taxation of out-of-state sales over the Internet, like:

– *Fairness*. Any solution should apply not only to Internet transactions but to all out-of-state transactions, including mail-order and telephone-based sales. Otherwise, the system would unfairly discriminate against e-commerce. Conversely, not taxing out-of-state transactions, including e-commerce, unfairly discriminates against traditional face- to-face transactions that are taxed.
– *Simplicity*. Any solution should avoid placing innovation-stifling burdens on the digital economy. Legislation should include explicit requirements for simplification across all states, not just within a state, so that out-of-state retailers are not subject to different rules and regulations from each of the fifty states. In addition, Congress should exempt small, out-of-state retailers from requirements to collect and remit sales taxes.
– *Parity*. The goal should be to establish parity in the collection costs between out-of-state retailers and single-jurisdiction retailers. One way to achieve this would be to require that states provide reasonable compensation to out-of-state retailers for expenses related to collecting and remitting sales tax.

Unfortunately suggesting the principles according to which the law should be created is much simpler than putting them into effect in form of a coherent law. Awareness of the need to tax e-commerce obliges public authorities to look for different solutions, both at the level of single state and international level. But no fiscal solutions in this field points to the particular difficulty. Several years ago S.R. Salbu pointed to two thorny problems plague the current e-commerce regulatory regime: vagueness and complexity[23]. The issues unsolved up to now.

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[21] *Taxation and Customs: Commission Proposes New European Cooperation Programme*. "Europe-East" November 21 2011. p. 303679, available AT: ec.europa.eu.

[22] D. Castro: *Create a Fair and Simple Tax for E-Commerce*. The Information Technology & Innovation Foundation, February 2012, pp. 3-4.

[23] S.R. Salbu: *Who Should Govern the Internet? Monitoring and Supporting a New Frontier*. 11 Harv. J.L. & Tech. 429, 461 (1998).

Conclusion

There is no doubt that global financial integration has increased considerably since the 1970s, though the major industrial economies and a few offshore financial centres and developing countries account for most of this 'global' phenomenon. Almost all developed economies followed, if with substantial delays in many cases, the lead of the US in 1973 to remove capital controls. Some important developing countries in Latin America and East Asia also removed many capital controls in the late 1980s and the 1990s. However in financial flows we are experiencing the dynamic development of the situation from beginning 90s. Last two decades delivered to us remarkable development of the technology, and hence a development of new opportunities of the economic activity – also in the field of e-commerce. E-commerce gets more of the headlines, probably because it's recognised as such an important new feature of the global economy. It does beg fundamental questions about the way our taxation systems work – whether it's taxation of company profits or taxation of private consumption. The technology that makes e-commerce what it is puts more of a spotlight on the possible challenges to effective taxation – just how do you tax a cyber-business, or all those sales over the Net? E-commerce makes international trade in particular so much easier, and so the debate about taxation moves up the international level, too. But on the other hand e-commerce makes tax evasion more widespread, easy, and considerable.

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Summary

Since 1980, "globalization" has become a key word for organizing our thoughts as to how the world works. Globalization, with its wide implications, can be discussed in various perspectives, such as socio-cultural political and economics. Economists define it as the free movement of goods, services, labour and capital across borders. World Bank defines globalization as "Freedom and ability of individuals and firms to initiate voluntary economic transactions with residents of other countries". Rapid growth of communication technologies such as internet, telephone, cellular phone, satellite and so on had a great impact on the financial globalization building new globalized financial architecture for both private and public entities. Capacity to link people, information and ideas around the globe has changed culture, society and economy, both positively and negatively. In this case, new challenges have emerged also in the field of taxation. This article examines the taxation challenges of e-commerce and discusses the current responses at the academic level, national level, and international level. This discussion concludes that a satisfactory answer to the challenges has not yet arisen, and the need for a different response is essential in this age of e-commerce.

Keywords: tax, e-commerce